ADDITIONAL DISSENTING VIEWS TO S. 256
Concerning the Unlimited Homestead Exemption

In addition to the concerns raised in the general dissenting views, we remain disappointed by the Committee's consistent refusal to put an end to two of the most notorious abuses of the bankruptcy system--the financial planning strategy by which debtors are able to purchase expensive homes in states which allow a debtor to exempt an interest in a primary residence of a unlimited dollar value,[1] and the development of "asset protection trusts," which would allow individuals to set up a trust for which they are the sole beneficiaries, and potentially place substantial assets outside the estate, and beyond the reach of the creditors.

I. THE UNLIMITED HOMESTEAD EXEMPTION.

The unlimited homestead exemption, known s the "millionaires' loophole," has allowed the very wealthy to shield from their creditors vast sums of money in palatial homes. The current Code allows a debtor to claim a state's exemptions.[2] A state may "opt out" and bar a debtor from using the federal exemptions in sec. 522(d), which are, in many cases, lower than exemptions allowed under state law.[3]

Over the years, many of us have offered amendments that would have placed an overall limit on state homestead exemptions, or repealed state opt-out so that debtors would be able to avail themselves of the federal exemptions if they are higher than applicable state law[4]. In each case, these proposals have been rejected. A proposal to place an absolute cap on state homestead exemptions in the amount of $1 million was even rejected by House conferees to H.R. 333 in the 107th Congress. Apparently, the proponents of this legislation believe that there is no amount too high for the wealthiest debtors to shelter in their homesteads, and that the poorest debtors are not entitled to even the modest floor provided by federal law.[5]

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[1] The following are the states have unlimited homestead exemptions: Florida, Iowa, Kansas, South Dakota, Texas, and the District of Colombia.

[2] 11 U.S.C. 522(b)(2)(A).

[3] 11 U.S.C. 522(b)(1).

[4] Rep. Waters offered an amendment setting a $30,000 Federal minimum homestead exemption for debtors 62 and older to protect some or all of the value of their homes from credentials in bankruptcy. The amendment was rejected by voice vote. Rep. Berman and Rep. Meehan offered an amendment to create a uniform Federal floor for homestead exemptions of $150,000 for debtors with substantial medical debts or a substantial loss in income, alimony, or child support due to medical problems. The amendment was rejected with 13 ayes and 18 noes.

[5] 11 U.S.C. 522(d)(1) allows a debtor to exempt up to $18,450 in value in the debtor's residence.

These proposals would have, respectively, helped to eliminate the biggest loophole in the Bankruptcy Code, and eliminate a significant inequity for homeowners of the most modest means. The proposals reflect the recommendations of the National Bankruptcy Review Commission, that Congress provide a meaningful cap on homestead exemptions as well as a federal floor.[6]

The rationale that has been given for the so-called `needs-based' reforms proposed in S. 256 is to eliminate abuses of the bankruptcy laws-abuses which proponents of the legislation have characterized as the use of the Bankruptcy Code as a `financial planning tool.'

Yet while the bill would presume that debtors of modest means are abusing the system if they can pay general unsecured creditors as little as $100 a month in chapter 13, it continues to permit, indeed it endorses--the most notorious abuse of the consumer bankruptcy system of all.

If the sponsors were truly serious about curtailing abuses in bankruptcy, this is the place to start. Some of the more notorious cases have included:

- Marvin Warner, a former ambassador to Switzerland and the owner of a failed Ohio Savings & Loan, who paid off only a fraction of $300 million in bankruptcy claims while keeping his multi-million-dollar horse ranch near Ocala, Florida.[7]

- Martin A. Siegel, a former Wall Street investment banker convicted of insider trading. While facing a $2.75 billion civil suit, he bought a $3.25 million, 7,000-square-foot beachfront home in Ponte Vedra Beach. [8]

- Former baseball commissioner Bowie Kuhn, whose Manhattan law firm went into bankruptcy. After creditors seized his weekend house in the Hamptons and were about to attach his $1.2 million home in Ridgewood, New Jersey, Kuhn acquired a million-dollar house in Florida with five bedrooms and five baths.[9]

- Dr. Carlos Garcia-Rivera, a Miami physician with no malpractice insurance, who was named in four separate malpractice actions, filed for bankruptcy protection, and kept a

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[6]BANKRUPTCY: THE NEXT TWENTY YEARS, FINAL REPORT OF THE NATIONAL BANKRUPTCY REVIEW COMMISSION, Recommendation 1.2.2, at 125 - 133 (Oct. 20, 1997). The Commssion recommended a national cap of $100,000, and a national floor of $20,000.

[7] Larry Rohter, `Rich Debtors Finding Shelter Under a Populist Florida Law,' *N.Y. Times* A-1 (July 25, 1993).

[8]*Id.*

[9] *Id.*

$500,000 home with a 100-foot swimming pool.[10]

! Dallas developer, Talmadge Wayne Tinsley, who filed under chapter 7 after incurring $60 million in debts. Tinsley objected to the Texas law that permitted him to keep only one acre of his $3.5 million, 3.1-acre magnolia-lined estate. But that acre included a five-bedroom, six-and-a-half-bath mansion with two studies, a pool and a guest house.[11]

! Movie actor, Burt Reynolds, who declared bankruptcy in 1996, claiming more than $10 million in debt. Reynolds kept a $2.5 million home--appropriately named `Valhalla'--while his creditors received 20 cents on the dollar. [12]

! Paul Bilzerian, who used Florida's unlimited homestead exemption to avoid his creditors. He filed for bankruptcy in 1991, and filed again last month. He retains his $5 million Florida home, and can completely avoid the $200 million in debt owed his creditors, including the IRS.[13]

The situation in Florida has become so notorious that one Miami bankruptcy judge told the *New York Times*, "You could shelter the Taj Mahal in this state and no one could do anything about it."[14]

As the *Wall Street Journal* noted recently concerning the Kuhn case, `the bill that Congress will soon send to a welcoming President Bush would make [pre-bankruptcy planning using the unlimited homestead exemption] more difficult, but that's symbolic. Few people anticipating bankruptcy have the cash to pull off that maneuver. This is a national problem that demands a uniform solution. Without a nationwide cap, debtors who live in the 45 states that cap the exemption at $200,000 or less are free to relocate to one of the five so-called `debtors' paradises' that have no cap at all.' [15]

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[10]David J. Morrow, `Key to a Cozier Bankruptcy: Location, Location, Location,' *N.Y. Times*, A-1 (Jan. 7, 1998).

[11] *Id.*

[12]Eliot Kleinberg, `Reynolds Gets Out from under Bankruptcy,' *The Palm Beach Post*, (Oct. 8, 1998)

[13] *Hearing Before the Senate Committee on the Judiciary on S. 220*, (Written statement of Brady C. Williamson), at 6 (Feb. 8, 2001).

[14]Judge A. Jay Cristol, quoted in Rohter, *supra* note 6.

[15]*Footnote 10:* David Wessel, `A Law's Muddled Course,' *The Wall Street Journal*, at 1 (Feb. 22, 2001).

Indeed, the Florida Supreme Court has ruled that even fraudulent transfers are protected by the unlimited homestead exemption under that state's constitution.[16]

The sponsors try to claim that they have closed the loophole by placing certain restrictions on state homestead exemptions. While true, these restrictions still leave the unlimited homestead exemption largely intact for most wealthy debtors. To the extent that the restrictions may prevent some forms of abuse, they will also have unintended consequences that might harm innocent debtors who inadvertently run afoul of the complex new rules attached to exempt property.

The bill does not place an absolute national dollar cap on homestead exemptions. People who, with the exceptions made in the bill as described below, would otherwise be entitled to an unlimited homestead exemption, would still be able to claim the exemption.

The bill does not alter the opt out rule in the Bankruptcy Code, so there is still no federal floor.

Domiciliary Requirement: The domiciliary requirement determines which state's exemptions the debtor is allowed to claim.

Sec. 307 of the bill requires a debtor to claim as a domiciliary the place of residence for the greater part of the 730 days preceding the date of the filing of the petition. This applies for claiming any property exemptions, not just the homestead exemption. Current law is 180 days.

While it would make pre-bankruptcy planning more difficult for a wealthy debtor seeking a jurisdiction with generous property exemptions, it would also have a substantial impact on a debtor who moves from a jurisdiction with a low exemption to a jurisdiction with a high exemption.

For example, a debtor who lives in New York and retires to Florida would get caught in this net. If the debtor sold her home in New York, moved to Florida, and purchased a home in Florida with the proceeds of the sale, became sick and had to file for bankruptcy (which is a common occurrence) within the 730 period, she would not be able to use the Florida exemption and keep the full value of her home. Instead, she would have to use the New York exemption of $10,000. The rest would be available to pay her creditors. If there is excess value (above the equity and transaction costs) the trustee would have a duty to sell the home to generate funds to pay creditors. The debtor would get a check for $10,000, and lose her home. This would be even less than the federal exemption of $18,450, so she would be harmed even more by the failure of Congress to adopt a federal floor.

Converting a non-exempt asset into an exempt homestead asset: The bill provides, in

[16] *Havoco of America, Ltd.* v. *Hill*, No. SC 99-98 (June 21, 2001).

sec. 308, that a debtor who converted a non-exempt asset into an interest in an exempt homestead within the ten year period ending on the date of the filing of the petition, would have the allowed exemption reduced by the amount of that additional interest. This provision requires proof that the debtor did so with the intent to hinder, delay or defraud a creditor. Because this is such a high standard of proof, it is likely that this provision will be rarely enforced.

Example: Debtor has $100,000 in a bank account. Debtor closes the account and uses it to pay down a mortgage on her residence. She now $150,000 in the home, all of which is exempt. The debtor would get to claim the full amount as exempt unless a creditor is able to prove that the debtor moved the funds from the non-exempt asset (the bank account) to the exempt asset (the homestead) with the intent to hinder delay and defraud a creditor. If the creditor is able to meet that burden of proof, the debtor may claim only the $50,000 interest in the homestead as exempt.

Another domiciliary requirement and conversion of non-exempt assets limitation:

Sec. 322 limits a debtor to $125,000 in a homestead exemption for any interest in a homestead that was acquired 1215 days before the date of the filing of the petition that exceeds in the aggregate $125,000 in value. It does not apply to a debtor who is a family farmer under ch. 12 of the Code, or a debtor who acquires the interest within the same state. It only applies to a debtor who acquires the interest in a homestead in a state other than the state in which the debtor lived within the look-back period. Thus, if a debtor who lived in Texas acquired an interest in a homestead in Texas during the look-back period, the $125,000 cap would not apply. It would, however, apply to a New York senior who sold her home, moved to Florida, purchased a home in Florida with the proceeds from the sale of the New York home, got sick and had to file within the 1215-day period. Because she would have acquired an interest in the property in excess of $125,000, she would be limited to $125,000. The rest of her equity could be used to pay her creditors.

Cap on homestead exemption for certain types of wrongdoing:

Sec. 322 also caps a debtor's homestead exemption at $125,000, if:

– The court, after notice and a hearing, determines that the debtor has been convicted of a felony, as defined in 18 U.S.C. 3156, which, under the circumstances, demonstrating that the filing of the case was an abuse of the provisions of the Code;

– The debtor owes a debt arising from a violation of the Federal or State securities laws; fraud, deceit or manipulation in a fiduciary capacity or in connection with he purchase or sale fo any security registered under section 12 or 15(d) of the Securities Exchange Act of 1934, or section 6 of the Securities Act of `1933; any civil remedy under 18 U.S.C. 1964 [the RICO statute]; any criminal act, intentional tort, or willful or reckless misconduct that caused serious physical injury or death to another individual in the preceding 5 years. The last clause does not include simple negligence resulting in serious physical injury or death. This reflects a concern among some proponents of the bill that doctors whose malpractice caused serious physical injury or death not lose their unlimited homestead exemption. The limitations due to securities violations and the RICO judgments were added in response to concerns that former Enron Chairman Kenneth Lay would be entitled to an unlimited homestead exemption in his native Texas should he file for bankruptcy. Mr. Lay has not, however, filed for bankruptcy, and it is not yet clear whether he will be found by a court to have run afoul of any of the enumerated offenses.

There is also a savings clause that a debtor who owes a debt of the kind described above would not lose her homestead exemption over $125,000, to the extent that the equity is reasonably necessary for the support of the debtor and any dependent of the debtor. It is an outrage that the same "reasonably necessary standard" that would protect the unlimited homestead exemption is the same one that the drafters of the bill specifically chose to remove from the Code, in favor the means test in sec. 102 of the bill, and the IRS standards to determine a debtor's allowed expenses.

While these amendments may eliminate a few of the abuses, they do not solve the problem. Wealthy debtors who are able to afford skillful legal advice, and are sophisticated enough to engage in complex pre-bankruptcy planning, will, in many cases, will be able to evade the paltry restrictions in this bill. Truly needy debtors, the kind whose life savings may be bound up in their residence, and who can afford neither sophisticated legal advice, or complex pre-bankruptcy planning, will get caught in the many twists and turns that will now be added to the Code. Far from eliminating the abuse of the unlimited homestead exemption, this bill will have the perverse effect of perpetuating it while creating new traps for the truly needy unsophisticated debtor.

What message does it send when Congress subjects middle-class debtors to a means test and other onerous changes to the Code, while permitting the wealthy to continue to place their millions out of reach of their creditors? A bill this rife with favoritism toward wealthy debtors and against middle class families is anything but a "Bankruptcy Abuse Prevention and Consumer Protection Act."

If Congress is serious about curbing abuse, a national, absolute dollar amount cap, without any loopholes, is the only way to do it. The bill, as reported, fails this test and so bears the burden of treating poor and middle class families harshly while letting the wealthiest individuals, who are clearly abusing the system and defrauding their creditors, shelter millions of dollars.

II. THE BILL DOES NOT ADDRESS THE ASSET PROTECTION TRUST LOOPHOLE.

Although this legislation is exceedingly draconian with respect to low and middle income debtors, the sponsors have consistently resisted amendments that would close loopholes for the wealthiest debtors.

One such loophole is the so-called "asset protection trusts," which, under the law of five states, allows an individual to set up a trust account for which the person establishing the trust would also be the beneficiary.[17] Trusts, established under non-bankruptcy law, are not treated a property of the bankruptcy estate, and so are beyond the reach of creditors.[18] A debtor may, under the laws of these five states, establish such a trust, solely for the benefit of the debtor, and may be able to shield unlimited amounts of money from creditors. So long as the funds were not placed in the trust by means of a fraudulent transfer, the trustee might have no power to recover them for the benefit of the creditors.

Senator Schumer offered an amendment that would have limited the value of assets that could be shielded in these trusts to $125,000, if transferred within the ten years preceding the filing of the petition.[19] Rep. Delahunt offered a similar amendment during the Judiciary Committee's markup, limiting such trusts up to $125,000, while protecting conventional retirement funds currently exempt from federal taxation, charitable trusts, and educational trusts. The amendment was rejected with 10 ayes and 15 noes.

The rejection of these reasonable amendments by the Senate and by the House Judiciary Committee again demonstrate that, despite its lofty title, the bill does not target bankruptcy abuse by the wealthy and well connected.

Bankruptcy should provide a safety net for families truly in need of relief. This legislation, which imposes stringent new rules on financially distressed families, should not leave the most notorious loopholes for the very wealthy.

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[17] Gretchen Morgenson, *Proposed Law on Bankruptcy Has Loophole*, N. Y. TIMES, Mar. 2, 2005, at C1.

[18] 11 U.S.C. 541(c)(2) (2004).

[19] 151 CONG. REC. S1981 (daily ed. March 2, 2005) (statement of Sen. Schumer). The amendment excludes from its coverage trusts not for the benefit of the debtor that would otherwise be excluded from the estate, and trusts established for retirement purposes under the new 11 U.S.C. 522(d)(12).